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United States Agency for International Development
Chisinau, Moldova

SUBJECT: **Contract No.: NIS-I-00-99-00001-00, TO#802**
 National Bank of Moldova: Bank Infrastructure and Development
 Final Report

Dear Dr. Nguyen:

Barents Group of KPMG Consulting is pleased to submit the final report for the above referenced project. The report includes a detailed breakdown of benchmarks achieved throughout the period from March 2001-May 2002.

We are very pleased with the overall results achieved under this task order. As discussed in detail throughout the report, the program in Moldova experienced progressive accomplishments in the areas originally set forth in the task order. For your convenience, we are also enclosing a CD-ROM copy of the report that provides links to the various documents referenced in this report.

If you need additional copies please feel free to contact me at (703) 747-3248.

Very truly yours,

Barents Group of KPMG Consulting, LLC

James E. Horner
Managing Director

cc: Resident Advisor Crozier
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 Resident Advisor Hemmen
 Project File

USAID
MOLDOVA
Moldova Bank Supervision
National Bank of Moldova
Final Report
May 19, 2002

United States Agency for International Development
Moldova Financial Sector Infrastructure Support – Bank Supervision
National Bank of Moldova - Bank Supervision
Contract No. OUT-NIS-I-00-99-00001-00
Task Order No: 802
USAID Cognizant Technical Officer: Dr. Tuan A. Nguyen
USAID Cognizant Technical Office: Chisinau, Moldova

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I. PREFACE

This report summarizes the assistance of Barents Group of KPMG Consulting LLC (Barents) to the National Bank of Moldova (NBM) and the Bank Association of Moldova (BAM) as contracted and funded by the United States Agency for International Development (USAID).

Through USAID, Barents has provided assistance to the NBM since 1995. This report covers the fourth stage of USAID's effort – February 2001 through May 2002. Please refer to the section titled "Brief History of the Banking Project" for an overview of stages one through three.

The format of this report follows guidance under Article III, item No. 3 which requests the resident advisors team to evaluate the gains made by the NBM and its personnel on each of the tasks delineated in Article I of the Task Order.

II. EXECUTIVE SUMMARY

This task order addresses USAID's Strategic Objective 1.4: *A more competitive and market-responsive private financial sector*. As the Task Order states: "One particularly critical Intermediate Result of Strategic Objective 1.4, which this task order addresses is 'A Sound, Regulated and Efficient Banking System Established.' "

The task order also supports Strategic Objective 1.3: Accelerated development and growth of private enterprises, which are the primary beneficiaries of a safe and sound and more efficient banking system infrastructure.

The specific objectives of this task order were to

- Support the development of a professional Bank Supervision Department at the National Bank of Moldova (NBM)
- Support the National Bank of Moldova's efforts to improve the safety and soundness of the banking system through capital strengthening and sector consolidation

This stage of the Moldovan Bank Supervision Project was the first time that a USAID project had focused on and was directed at the NBM's on-site bank supervision process. Continued assistance was also provided to the NBM's accounting function and to the commercial banks' Bankers' Association. Efforts directed at the latter were aimed at helping to improve the communication between the Association and the NBM.

One of this stage's main activities was the determination of the NBM's compliance with the Basel Committee's "*Core Principles of Effective Banking Supervision*." The bank received the resulting report of that assessment, as well as assistance in developing a program to address areas of less than full compliance.

USAID had not provided direct and hands-on assistance to the NBM on-site process, and the advisors quickly determined that the function's status was not as well developed and efficient as had been perceived previously. Many factors had contributed to this situation, especially high turnover among the on-site staff and the previous paucity of in-bank assistance during bank inspections. Much of this project's total effort was, therefore, directed at replacing the NBM's previous checklist, compliance-with-regulations mentality and methodology with an inspection approach and attitude based on risk-based analyses.

Guidance in improving overall analytical performance was applied within many of the specific objectives required by the task order. For example, significant effort was directed at helping NBM inspectors learn and apply appropriate credit evaluation techniques rather than concentrating only on the existence of collateral. The use of risk-based analyses was also stressed during the development and use of the new format for the Reports of Inspection and in the creation of various components of the NBM's management information systems, especially the quarterly summary of activity and conditions in the banking system as a whole.

Progress was also made in specific areas within the on-site process, especially Information Technology. A short-term advisor made two visits to the NBM, and provided formal workshops for both the NBM and commercial bankers, as well as guidance during on-site inspections. In addition, the advisor developed a IT chapter and inspection procedures for the NBM's Inspection Manual.

The NBM and commercial bankers also received formal training in foreign exchange and derivatives. The NBM's staff was provided a course on the analysis of banks' financial statements. And, at the NBM's repeated insistence, significant time and energy was directed toward foreign exchange and derivatives to fulfill IMF directives, although neither is currently viewed as a high-risk area. In addition to training, the NBM received chapters for the Inspection Manual, which included inspection procedures, and related help with the chart of accounts.

As required by the task order, the advisors provided assistance in developing an accreditation program for NBM inspectors, recommended changes and revisions to the NBM Inspection Manual, and developed a plan to better integrate the on-site and off-site supervision functions.

The assistance given to the NBM's Accounting Department included further training in International Accounting Standards and continued work on the NBM's Chart of Accounts.

The Moldovan Bankers' Association also received assistance. This help was primarily a determination of the measures that would benefit the country's banks in the future. A strong central bank has to be accompanied by a high-quality private banking system.

III. BRIEF HISTORY AND STATUS OF THE BANKING PROJECT

The project began in August 1995. Its immediate goal was to help develop international accounting practices in the banking system and to work with the National Bank of Moldova (NBM) in developing an effective bank regulatory structure to oversee the transition of the banking system from a centrally planned to a market-based, demand economy.

A. STAGE ONE

A number of important steps were accomplished during the project's first two years. Accounting training in international accounting practices was provided to all commercial bankers and the NBM's accounting staff. This stage of the project also included the development of a standard chart of accounts and a set of financial statements for commercial banks. Assistance provided to the NBM's regulatory function included the creation of a problem bank resolution unit and an off-site monitoring unit. The development of training programs, management information systems, banking laws and regulations, and supervisory manuals was also begun. In addition, three banks were put into receivership and ten banks were put under the direct supervision of the NBM.

B. STAGE TWO

The project's second two-year stage addressed the banking system's need to adopt and adhere to international accounting practices and to strengthen the NBM's internal reporting and internal controls. Continued emphasis was given to training for both NBM staff and commercial bankers in making best use of analytical tools and processes. Significant progress in reaching conformance with International Accounting Standards (IAS) was made in January 1998, when all commercial banks converted to National Accounting Standards (NAS) and adopted a uniform chart of accounts and financial statements. The adoption of a uniform chart of accounts allows the NBM to collect bank data in reports prepared according to standardized formats.

C. STAGE THREE

The project's overall strategic objective during this stage was to help create a more competitive and market-responsive financial sector through the development of the financial infrastructure. Advisors worked with three distinct counterparts during this phase: the NBM's Accounting Department, the NBM's Bank Supervision Department, and the commercial banks' Bankers' Association.

■ **NBM Accounting Department**

The advisors provided several recommendations designed to improve the Accounting Department. These recommendations ranged from the reorganization of the Department to developing methods and procedures section to maintain the chart of accounts. The advisors also provided training to the NBM on a variety of accounting topics.

■ **NBM Bank Supervision Department**

Significant work was done with the Bank Supervisors, especially the off-site staff. The NBM implemented and began using an Early Warning System (EWS) that works in conjunction with the Bank Performance Reports (UBPRs) produced by the computerized Bank Offsite Surveillance System (BOSS). The NBM's management information systems were enhanced, with special attention given to the Administrative Council Report (ACR), which informs senior NBM management of system-wide trends and conditions and provides updates on specific problem banks. NBM management requested help with the drafting of two regulations: bank transparency and the classification of assets other than loans. Many formal training courses were conducted for the on-site and off-site functions of the NBM's supervisory staff. Formal classroom and informal one-on-one accounting training was provided to the system's commercial banks. IAS and internal audit training were provided via formal classroom training sessions provided on a frequent basis.

■ **Bankers' Association of Moldova**

Extensive work was done with the Bankers' Association. The main goals were to assess the current status of the association and determine how it might become a more viable and effective professional alliance.

IV. CURRENT STATUS: STAGE FOUR

Note: This section follows Benchmarks in the Task Order with adjustments agreed upon September 20, 2001 between USAID and Barents Group LLC. In some cases an item may relate to more than one Benchmark. Simply click on the link in the listing below to view the document.

A. OVERVIEW

The project's current, and fourth, stage was a one-year project that focused mainly on the National Bank's on-site supervision process. Assistance was also provided to the NBM's Accounting Department and the Bankers' Association.

Assistance provided to the NBM fell into two broad major categories: 1) Training and Skills Enhancement and 2) System and Structural Revisions. Additional guidance and counseling was provided at the NBM's request on numerous issues.

B. BENCHMARKS

#1 “The contractor shall establish the resident(s) in the country in not more than 30 days after the contract award.”

Advisor Crozier arrived in Moldova March 7. Advisor Guilfoyle arrived later following approval by the CTO.

#2 “Within 30 days after the advisor(s) take up residence, a written evaluation of priority training needs (at both the entry and advanced level) and a draft schedule for their delivery is required.”

Training and skills enhancement was an area of major focus. Significant time and resources were given to increasing the NBM's knowledge base. The evaluation was completed in early April and presented to the NBM. A training schedule was then developed based on the results of the evaluation and on specific NBM requests. The activities included formal classroom training sessions for both the Accounting Department and The Bank Supervision Department and on-the-job training during bank inspections and counseling sessions within the NBM.

The training sessions conducted during this phase of the project included both formal, two-day interactive workshops to bank supervision and twice-weekly workshops on International Accounting Standards to the accounting department. Where possible, follow-up on-the-job training was provided to reinforce the workshops' lessons to both departments. This process was especially helpful in the areas of Information Technology, International Accounting Standard 39 and foreign exchange.

The workshops addressed the topics of Accounting, Information Technology, Foreign Exchange, Derivatives, Analysis of Bank Financial Statements for supervisors from both on- and off-site areas, and the Revised Report of Inspection.

- Evaluation of priority needs:
 - Training Evaluation, [Part I](#) & [Part 2](#)
 - [Courses taken in Moldova](#)
 - [Courses taken outside Moldova](#)

- Material related to classroom training:
 - [Foreign Exchange class](#) (Power Point presentation)
 - Foreign Exchange exercise [1](#) & [2](#)
 - [Derivatives class](#) (Power Point presentation)
 - [Derivatives exercises](#)
 - [Loan vs counterparty risk](#)
 - [Bank Financial Analysis](#) Class (Power Point presentation)
 - [Bank Financial Analysis exercises](#)
 - [List of key ratios](#)
 - [Sources and uses of funds exercise](#)
 - What do financial ratios tell us: [discussion](#), [ratio recap](#), [guidelines](#)
- Memos:
 - [5june2001](#): Proposed schedule for capital markets products

#3 “Within 60 days after the advisor(s) take up residence, the contractor will carry out an evaluation of the NBM’s compliance with the Basle Core Principles. This evaluation will assess the efficacy of the on-site/off-site supervision processes, tools and level of integration of international standards into the supervisory processes of the NBM.”

During the second quarter, Barents conducted an assessment of the NBM’s compliance with the “Core Principles” according to the *Core Principles Methodology* prepared by the Basle Committee on Banking Supervision. Upon completion of that assessment, Barents provided a seventy-five page written report detailing the NBM’s level of compliance with each of the twenty-five principles.

After issuing that report, Barents aided the NBM in determining the measures needed to address those principles where significant noncompliance had been noted (those principles involved Country and Transfer Risk, Market Risk, Money Laundering, Consolidated Supervision, and Cross Border Supervision). The assistance provided in this regard included background materials and in-depth explanations of some topics (especially for the areas of Country/Transfer Risk and Market Risk) and various detailed recommendations for overcoming structural and legal impediments.

- [Basle Core Principles Assessment](#)
- [Basle Compliance Program](#)
- Memos:
 - [22jan2002](#) Material for Exam Manual covering market risk
 - [Collateral Damage](#)

#4 “Within 60 days after the advisor(s) take up residence, a draft policy is required regarding the examination of data processing operations (BDP) and procedures at the banks. By the end of the task order a new chapter in the on-site inspection manual (which has been tested in the banks and approved by the NBM management) dealing with exam procedures of BDP is required.”

The NBM requested special emphasis in the area of Information Technology (IT). As a result, significant work was done in the IT area during the project. A short-term IT advisor made two trips to the NBM, the first in May and June. The NBM received policies, procedures, a chapter for the Examination Manual, classroom and on-site training, plus suggestions for future training and assistance. His efforts were very successful in establishing and implementing an IT examination function within the Supervision Department. He was also able, however, to coordinate his efforts and recommendations with the NBM's own IT Department, which will help provide future support to the Supervision Department's efforts.

The IT advisor conducted two training workshops for the NBM's IT inspectors and a separate session for the commercial banks. He went on-site to assist in IT examinations and provided feedback and advice regarding the report comments that resulted from those examinations. The IT advisor also provided an IT chapter for the NBM's Inspection Manual, which included procedures for IT inspections.

- [Internal Control Evaluation](#)
- [IT audit](#)
- [IT Inspection Report](#)
- [IT Manual Chapter](#)

#5 “Within 6 months after the advisor(s) take up residence, a draft revision to the current Report of Examination is required for submission to the Director of the Bank Supervision Department.”

The final draft of the new Report Format was presented to the NBM in early September. The working group of NBM staff and the Barents advisor and developed earlier versions during the summer. The format was accepted by NBM management and has been adopted for use by the on-site staff. The adoption and use of a revised format for the NBM's Reports of Inspection was a major accomplishment and far transcended the use of a new, shorter report shell. The benefits that resulted included the use of improved analytical processes, the determination of well-formed and supportable conclusions, and the presentation of information in a logical and meaningful order and format.

Although significant progress was made, the NBM will have to continue its efforts to help inspectors overcome their long-standing tendencies to provide information in the chronological order encouraged and facilitated by the prior format.

The use of the revised format will also help foster the continued use of risk-based analytical procedures, a greatly needed development. As noted elsewhere in this document, one of the more important issues worked on during many of the individual Task Order elements was overcoming the NBM's tendency to conduct regulation-driven, checklist-based inspections and analyses, which were reported in a chronological format with little or no consideration given to prioritizing or organizing the results or conclusions.

- [Report of Examination Presentation](#)
- [New Report of Examination](#)

#6 “Within six months after the advisor(s) take up residence, a written draft plan will be completed, with recommendations for the Deputy Governor in charge of Supervision, on an institutionalized process for integrating work of the different Bank Supervision Units. By the end of this task a final draft approved by the Deputy Governor is required.”

A comprehensive plan to foster integration of off- and on-site functions has been presented to Supervision Department management for formal approval. The plan includes expanded cross-training and job rotation to ensure supervisory staff is well rounded and knowledgeable in their respective roles. The NBM received the draft integration plan in the third quarter. The advisors helped implement a revised monthly report on the financial condition of the banking system using a risk-based methodology (CAMELS) similar to that used in on-site examinations. Management plans to expand this to include quarterly reports on individual banks.

The advisors helped implement a part of the plan that involved making the monthly banking system report prepared for the NBM Administrative Council more analytical and risk-focused. The revised report uses a modified CAMELS framework similar to that used to evaluate risk in on-site examinations. Management plans to expand this format to include quarterly reports on individual banks.

- [Issues in Consolidated Supervision](#)
- [Banca ExIm](#): translation of exam report and notes from BOSS analysis

- [Question re Import Export](#): questions about points raised in the exam report
- [Integration notes](#): initial observations about the level of integration and how to proceed
- [Sources and uses](#): sources and uses of funds statement prepared for inclusion in the revised monthly banking system report
- [System report](#): questions about the 9/30/01 system-wide BOSS report
- [System risk profile](#): initial attempt at a revised monthly report, prepared together with NBM off-site staff
- [Formatul nou al raportului pe sept.2001](#): new monthly banking system report for Administrative Council
- Memos:
 - [15july2001](#): Suggestions for improving the supervisory process
 - [20 sept2001](#): Proposed plan for integration of Bank Supervision units
 - [20sept2001](#): Comments re: Banca “Export-Import” Inspection Report
 - [12nov2001](#): Delays to implementation of revised monthly banking system report

#7 “Within 9 months after the advisor(s) take up residence, a written draft plan for establishing standardized policies and procedures for rehabilitating/resolving/liquidating problem and failed institutions is required.”

As of September 20, 2001, the terms of the Task Order were changed at the direction of the CTO. This item was deleted and the action plan adjusted because the designated advisor who was to work on this project was eliminated from the program.

#8 “By the end of this Task Order, the advisor(s) will have assisted in actual in-bank examinations in banks accounting for at least half of the assets of the banking system. In addition to enhancing the quality and effectiveness of these examinations, the contractor’s advisors will have developed a cadre of NBM bank examiners with on-site training in the use of examination procedures for the CAMEL components. This includes guidance for examination planning and coordination.”

Considerable efforts were made to provide assistance and counseling in the NBM’s on-site process. This phase of the project marked the first time that USAID had provided actual assistance during on-site inspections. Previous assistance to the on-site process had been the responsibility of other donors, but

they had provided little in the way of actual on-site counseling. Advisors assisted in on-site reviews of six banks, including the largest with roughly 24% of the system's total assets and 21% of total capital. Specific in-bank training was provided in assessment of asset quality, evaluation of management, and foreign exchange.

After an initial hesitancy on the part of the NMB and sundry bureaucratic obstacles were overcome and resolved, the on-site counseling and training process was very successful. Although much remains to be accomplished in this area, important steps were taken to establish the groundwork for future improvements. Significant progress was made in the use of improved analytical methods (Risk-Based) for the evaluation of all areas of commercial banks' activities.

Much of the assistance provided during on-site inspections focused on the credit evaluation process. The NBM's inspectors have historically paid too much attention to the existence of collateral rather than a borrower's capacity to repay. Considerable emphasis, therefore, was given to cash flow analysis in the context of assessing a borrower's creditworthiness. To encourage the proper review of credits, the inspectors were provided with a risk-focused loan review tool that will help guide their analyses. However, much work remains to be done in this area because of the NBM's long history of collateral-based analysis and the existence of inappropriate regulatory requirements (to be discussed later).

- [Asset quality comment](#); Sample of a report comment write-up
- [Asset quality](#); Proposed asset quality line card
- [Asset quality training](#); Instructions for line card
- [Banca Comerciala Romana](#); Discussion notes prepared during on-site assistance at BCR
- [Corporate governance](#); Discussion paper on this topic for discussion at on-site exam
- [Difficulties memo](#); File memo noting bureaucratic obstacles
- [Fonimob](#); Review of a borrower prepared for on-site exam at Universalbank
- [Further delays](#); Another memo about bureaucratic obstacles to be overcome
- [FX comment](#); Sample of an exam report comment on foreign exchange
- [Unibank](#); Questions I prepared to "engage" the inspectors when we started the on-site review
- Memos:
 - [31may2001](#); Preliminary observations about the effectiveness of the on-site process

- [27oct2001](#): Discussion notes from on-site participation at Universalbank
- [29oct2001](#): Observations from participation at recent on-site reviews
- [2nov2001](#): Observations from participation in on-site review at Victoriabank
- [20dec2001](#): Observations from participation at Banca Comerciala Romana
- [21jan2002](#): File memo re: cancellation of on-site assistance at Petrolbank
- [8feb2002](#): Thoughts on analysis of credit risk

#9 “By the end of this Task Order, an accreditation program for bank supervisors will have been approved by the Bank Supervision authority, and initial implementation will have begun.”

A four-point plan for developing and implementing a comprehensive accreditation program was developed and provided to NBM management. The plan addresses the initial hiring process, adoption and implementation of a formal training program, development of an effective and objective personnel evaluation process, and the determination of appropriate job descriptions and promotion criteria (including testing standards).

To successfully implement the proposed program, the NBM will need to obtain the expertise and guidance of Human Resources specialists to assist with the performance evaluation process and to ensure that any certification programs are based on valid and accurate tests.

The plan was developed after extensive consultation and discussions with the head of the Supervision and Bank Control Unit and an examination of the limits and restrictions placed on revisions to job titles and performance evaluation processes by Moldovan law.

As the implementation of a full accreditation program will be an extensive and time-consuming process, NBM management's review of the recommendations was continuing as the project concluded.

It was indicated, however, that the revised job descriptions would most likely be the first items to be adopted.

- [Accreditation Process Description](#): Describes the process of accreditation
- [Job Description](#): Sample job description for an Assistant Inspector

- [Timeline](#): Accreditation Plan timeline

#10 “By the end of this Task Order, the advisor(s) will provide evidence that some revisions have been made to the on-site inspection manual prepared in 1996, which brings this manual into accordance with current banking legislation and incorporates other innovations which have taken place in the financial system.”

In addition to providing new chapters and examination procedures for the topics of Information Technology, Foreign Exchange, Derivatives, Non-Ledger items, the advisors also provided information that NBM can adapt to their needs on Market Risk, Country Risk, and Money Laundering. The NBM will also incorporate the revised Report format in its manual.

In addition, during the course of the project the advisors compiled a list of recommended changes to existing sections of the Manual. Many of these recommendations were based on observations gained during participation in on-site inspections. This list was provided to NBM management during the project's last quarter.

- [Foreign exchange](#): Revised chapter covering foreign exchange
- [Derivatives](#): New chapter covering derivatives
- [Non-ledger items](#): New chapter covering non-ledger items
- [Market risk](#): Material for new chapter on market risk
- [Market valuations](#): Draft descriptions of market value and Valuations
- [Collateral](#): Chapter on Collateral
- [General recommendations](#):
- Memos:
 - [6june2001](#): Some thoughts on enhancing the NBM Exam Manual
 - [11jan2002](#): Suggestions for improving the Examination Manual
 - [22jan2002](#): Material for Exam Manual chapter covering market risk
 - [1feb2002](#): Draft Exam Manual chapter for non-ledger items
 - [Valuation issues](#): Response to questions raised on valuation issues
 - [Collateral damage](#): Arguments against requiring collateral

#11 “By the end of this Task Order, the advisor(s) will provide evidence that at least an important subset of regulations have been altered to conform to any amendments to the Law on the National Bank of Moldova and the Law on Financial Institutions.”

As of September 20, 2001, the terms of the Task Order were changed at the direction of the CTO. This item was deleted and the action plan adjusted because the designated advisor who was to work on this project was eliminated from the program.

#12 “By the end of this Task Order, the Bank Supervision Department will approve a policy, which delineates communication procedures with the banks and the public, and will provide evidence of implementation.”

As of September 20, 2001, the terms of the Task Order were changed at the direction of the CTO. This item was deleted and the action plan adjusted because the designated advisor who was to work on this project was eliminated from the program.

#13 “Provide technical assistance to the on-site process regarding commercial banks’ foreign exchange activities.”

In conjunction with formal classroom instruction, advisors developed a set of examination procedures for foreign exchange and provided counseling as to their use while on-site. At the insistence of NBM management, a comprehensive chapter was developed for derivatives even though these do not yet represent a critical risk area for the banking system.

While not specifically included in this Task Order, training was given to the NBM in financial derivatives. The advisors also prepared a comprehensive paper for use by the NBM to familiarize them with product types, associated risks, and accounting treatment. Although done at the insistence of NBM management to meet IMF directives, these resources will help them better understand the risk of these instruments when they do develop in the local market. The NBM also urgently requested and received advice on mainly off-site issues relating to capital markets products, including implementation of International Accounting Standard 39.

Seminars for both foreign exchange and derivatives were subsequently adapted and presented to participants from the commercial banks. The training in derivatives was particularly timely given the planned opening in Moldova of a derivatives exchange from Romania, the first of its kind.

- [Foreign exchange](#): Revised chapter covering foreign exchange
- [Derivatives](#): New chapter covering derivatives
- Material related to classroom training:
 - [Foreign Exchange class](#) (Power Point presentation)
 - [Foreign Exchange exercises](#)
 - [Derivatives class](#) (Power Point presentation)
 - [Derivatives exercises](#)
 - [Analysis list for derivatives](#) (in Romanian)
- [Loan vs counterparty risk](#)
- Memos:
 - [4june2001](#): Credit risk of derivatives
 - [5june2001](#): Proposed schedule: capital markets products
 - [14june2001](#): Notes of meeting with Agroinbank re: setting up trading limits
 - [10july2001](#): Foreign exchange seminar details
 - [3aug2001](#): Details of derivatives seminar
 - [4oct2001](#): Details of derivatives seminar for commercial bankers (extra spaces were provided to NBM staff)
 - [2nov2001](#): Foreign exchange examination procedures
 - [9jan2002](#): Exam Manual chapter on derivatives
 - [11jan2002](#): Organization of derivatives activities in commercial banks
 - [14jan2002](#): Margin requirements for securities credit transactions
 - [30jan2002](#): Implementation of IAS 39 for trading products by commercial banks
 - [4feb2002](#): Risks of dollar-indexed loans extended in lei

#14 “By the end of the task order NBM will have implemented a new chart of accounts. (addition formally agreed upon September 20, 2001).”

The original objective was to provide a chart of accounts that would be implemented at the time of conversion to a new accounting system. The NBM is in the process of installing new accounting software and asked for a review of their chart of accounts so any changes could be integrated with the systems upgrade. The implementation of the new accounting system was delayed until July 1, 2002; therefore, implementation of the new chart will be delayed. The chart has been completed and received final approval. With the changes in International Accounting Standards over the last year there is a need to insure that the accounts record appropriate data to be used in complying with the new International Accounting Standards. The process of preparing financial statements requires more analytical review than in the past and it is imperative that the general ledger has the data to make this analysis.

- [Chart of Accounts- A&L](#)
- [Chart of Accounts general layout](#)

#15 “By the end of this task order, the advisors will provide training to commercial banks in similar subjects as those received by bank examiners. In addition the accounting department of NBM will receive training of specific accounting issues.”

Significant assistance has been given to the banking system since 1995, but questions remain as to how well prepared commercial banks are to face foreign competition and to support growth in a market economy. A questionnaire was distributed to all commercial banks through the Bankers’ Association that requested the bankers’ thoughts about areas they believe they could use help. A report based on their responses was prepared by the Association that listed the areas of main concern.

Commercial bankers received courses similar to bank examiners in foreign exchange, derivatives and information technology. In addition the accounting department of NBM received training in International Accounting Standards. The standards covered in classes were those that were selected because of the difficulty in applying them. In addition to a review of the framework the standards selected were numbers 1, 7, 8, 10, 16, 18, 32, 36, 39 and 40. There was special emphasis on Standard 39 because of its impact on financial institution reporting.

- [Derivatives Class](#): (Power point presentation)
- [Derivatives exercises](#)
- [Foreign Exchange Class](#): (Power point presentation)
- [Foreign Exchange exercises](#)
- [Information Technology Systems and Risk Management Class](#): (Power point presentation)
- [IT handouts](#)
- [International Accounting Standards Seminar](#): Group discussions held over a couple months on IAS
- [IAS final test](#)
- [Accounting Department training needs](#): List prepared by NBM’s Accounting Department
- Memo’s;
 - [Useful life](#): Description of useful life
 - [Fair value](#): Definition of fair value
 - [Fixed asset accounting](#): Accounting for additional expenditures for fixed assets

- [Leasing](#): Misconception of leasing caused by National Accounting Standard
- [Loan definitions](#): What is an overnight placement
- [Recognition of loss](#): When should a loss be reported
- [Treasury stock gains](#): No gains are reported for the sale of Treasury stock just an adjustment to equity
- [Donations](#): How donations to a commercial should be reported
- [Accounting for accrued interest](#): Accounting for accrued interest on charged off loans

#16 “By the end of this task order the advisors will provide a prioritized list of issues commercial banks need addressed to improve profitability and strengthen their ability to compete.

A questionnaire was sent to all commercial banks through the bank association asking for areas the banks could use help in. The responses were reviewed and a report prepared listing the major areas. The 6 major areas of concern were: inconsistent laws, mandated but uncompensated government services, excessive reporting, lack of training, antiquated payment system and lack of a credit bureau.

- [Major problems facing the banking industry](#): Short developed by personal discussions and the banking survey
- [Key areas requiring improvement](#):
- [Bank Association prioritized issues](#): A list of issues developed by the bank association based on a survey of all commercial banks

V. ECONOMIC AND INDUSTRY DATA

A. STATUS OF THE MOLDOVAN ECONOMY

For the first few years after it gained independence in 1991, Moldova made significant progress in reforming, privatizing and stabilizing its economy. However, a sharp devaluation of the Russian ruble in August 1998 and the resulting financial crisis lead to soaring inflation, falling incomes, and drastically curtailed economic activity, which reversed many of the previous gains.

Moldova has a largely agricultural economy that has yet to fully recover from the collapse of trade links established in the Soviet period. It is by some definitions

the poorest country in Europe, with nearly every measure of economic and social lagging those elsewhere in the region. Inward investment ranks last among the emerging economies in Eastern Europe at only \$60 per capita annually, compared to over \$250 in the Czech Republic. The result has been lower levels of economic growth and reduced employment opportunities. Investors are discouraged by the lack of political stability, the prevalence of corruption, the small size of the market, as well as various legal and other obstacles.

The effect on the country's economy by the election of a Communist government in February 2001 has so far been mixed. On the one hand, both inflation and interest rates have continued their broad downward trends, with moderate growth in national income (GDP). The government was able to balance its budget for the first time ever in 2001 (Figure 1).

Figure 1: Key Macroeconomic Indicators

	1998	1999	2000	2001 ¹
Inflation Rate	18%	44%	18%	6.5%
Interest Rate 2	32.6%	43.9%	31.3%	17.8%
Nominal GDP (million lei)	9,122	12,204	15,980	18,280
% Change in Real GDP	-6.5%	-4.4%	1.9%	4.2%
Budget Deficit (million lei)	-305	-395	-166	13
State External Debt (million lei)	1,342	1,362	1,352	1,290
% of GDP	79.4%	117.2%	104.9%	90.8%

1 Preliminary data

2 Of 182-day treasury bills

Yet the government also has stalled on earlier commitments made to the IMF and other multilateral organizations to privatize key enterprises in the important wine and tobacco industries, and has failed to address both rampant corruption and the pervasive influence of organized crime. Moldova suffers under a very heavy debt burden, and July 2002 is critical in this regard as roughly \$70 million in Eurobonds will fall due. Default seems inevitable absent major restructuring by lenders.

B. OVERVIEW OF THE BANKING SECTOR

The banking system is one area where earlier reforms have remained intact. Of the 19 banks presently operating in Moldova, only one has minority state

ownership, representing just 6% of the sector's total capital. Moreover, two of the larger institutions have attracted external investment from the EBRD and other multilateral entities. At this writing there are a further nine banks in liquidation, and there were no bank closings in 2001.

The banking system has benefited from favorable economic trends over the past two years, and now has relatively high levels of capital and liquidity (Figure 2).

Figure 2: Key Banking System Indicators

	1998	1999	2000	2001
Nominal Total Assets (million lei)	2,660	3,201	4,668	5,994
Real Total Assets (million lei)	2,660	2,223	2,713	5,628
Total Deposits (million lei)	1,048	1,588	2,489	3,444
Real Total Deposits (million lei)	1,048	1,103	2,109	3,234
Risk-Weighted Capital as % of Total Asset	26.3%	26.5%	28.6%	26.4%
Principal 2 Liquidity	26.5%	39.0%	35.5%	34.6%

Nevertheless, banks continue to face a number of very significant obstacles to their prudent operation. These include:

■ **Limited discretionary income and a shallow pool of savings**

According to recent official data, median monthly income in Moldova is between \$25 and \$45, with fully 80% of the population living below the official poverty line. The lack of disposable income and resulting limited pool of savings has limited further deepening of the financial marketplace. This in turn constrains the flexibility banks have to prudently manage their risks.

■ **Lack of public confidence in the banking system**

Memories of bank failures, hyperinflation, and other events in the early 1990s and again in 1998-9 are still fresh in the minds of many Moldovans. Moreover, the use of banks by the Finance Ministry as a tax collection point furthers a general sense of public mistrust, and coupled with the lack of deposit insurance, this has helped drive a large volume of economic activity underground. Some

estimates place the volume of such black market activity as high as 65% of officially reported GDP.

■ **Lack of an effective legal system and poor business infrastructure**

A legal system that neither effectively protects creditors' rights nor renders fair and timely judgments is a major impediment to the business of banking. Existing laws on bankruptcy and lien holder rights must be revised to better define and protect banks' legitimate economic interests.

Collateral valuation techniques, especially for real property, also need improvement. As of this writing, a bill which includes appraisal standards modeled on those of TEGoVA (The European Group of Valuers Association) is before Parliament, and officials at the Cadastre Agency are optimistic it will be passed. The new law would establish standards for qualified appraisers and require greater use of market value as opposed to the "normative pricing" techniques currently in use. This is a key milestone in Moldova's evolution to a market-based economy, although the standards would be of even greater use if a large pool of data concerning comparable sales other related information were available.

Lending activity in particular is hurt by the lack of a means to independently investigate and verify borrowers' credit histories. The Banker's Association has proposed that the National Bank maintain such a database; however, the latter is opposed to this idea and no further progress has been made.

■ **Limited numbers of qualified borrowers**

Local bankers report that even though some borrowers may in fact be otherwise qualified to receive credit, many do not present accurate financial statements for purposes of tax evasion. A widespread distrust in the government and public institutions, the general belief that the government is both corrupt and inefficient, and the lack of political stability all encourage citizens and businesses to actively avoid taxation. Bankers confirm that prospective borrowers routinely provide financial data that underestimates their income or otherwise misstates their true financial position. This severely limits the amount of credit a bank is willing to extend.

VI. ANNEX 1 - TANGIBLE RESULTS

1.	<p>The bank supervision authority will have developed and begun implementation of an accreditation framework for NBM bank supervisors (i.e. overall strategy, time frames, and minimum standards). This accreditation program will train NBM staff in bank regulatory and examination issues such as collateral evaluation, basic credit principles, and foreign exchange management, among other things.</p> <p>The NBM received a program of accreditation for its bank supervisors that addressed elements from the hiring process through the promotion to the highest level, or rank, of supervisor. The program outlined time frames for development and implementation of its various steps. A number of the functions in this comprehensive program to be implemented in the future will require assistance from sources outside the NBM, and most likely from outside Moldova. Such areas should receive attention should work with the Supervision function continue after this project.</p>
2.	<p>The bank supervision authority will be using on a consistent basis tools previously introduced (i.e. Report of Examination format, examination procedures, work paper formats during all on-site examinations).</p> <p>The Supervision Department adopted and implemented a new Report of Inspection during this project. Training and explanatory sessions were held with both field inspectors and senior NBM management to explain the revised, more efficient, format. It was found, however, that the on-site inspectors were making little use of Examination Manuals, Examination Procedures, and work paper formats previously introduced by the IMF. During this project the importance of using both Examination Procedures and appropriate documentation methods was stressed and emphasized. Progress was made in regard to the use of Examination Procedures, but NMB management is still reluctant to adopt revised work paper procedures.</p>

3.	<p>On-site examination results will be communicated to bank management/directors through a formal process.</p> <p>The NBM has a formal process to advise bankers and directors of examination results. The process includes a formal, written Report and meetings with senior management and boards of directors. The new Report of Inspection format adopted during this Phase will further enhance the NBM's communications with the commercial banks.</p>
4.	<p>The Bank Supervision Department's on-site inspection manual will have incorporated changes, which flow from the passages of new banking laws, and will have enacted changes in the NBM regulatory framework, which are compatible with the amended laws.</p> <p>In addition to new chapters covering foreign exchange, derivatives, information technology, and non-ledger items, NBM management was provided with a list of suggested revisions for the Inspection Manual. As many of the revisions were the result of advisors' participation in on-site inspections, the list was prepared in the last quarter of the project. Senior management was reviewing those changes as the project ended.</p>
5.	<p>Based on amended banking laws, the NBM will have effectively put in place supervisory response policies and processes to establish and implement corrective action plans in the resolution of problem banks.</p> <p>As of September 20, 2001, the terms of the Task Order were changed at the direction of the CTO. This item was deleted and the action plan adjusted because the designated advisor who was to work on this project was eliminated from the program.</p>
6.	<p>The Bank Supervision Department will have a functioning, integrated process for problem bank identification, and have adopted supervisory policies for enforcement actions and problem bank resolution.</p> <p>As of September 20, 2001, the terms of the Task Order were changed at the direction of the CTO. This item was deleted and the action plan adjusted because the designated advisor who was to work on this</p>

	project was eliminated from the program.
7.	<p>The bank supervisory authority will have developed systems to enhance communication between the commercial banks and the NBM.</p> <p>As of September 20, 2001, the terms of the Task Order were changed at the direction of the CTO. This item was deleted from the action plan because the designated advisor who was to work on this project was eliminated from the program.</p>